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WARRANTIES ON COMMERCIAL ITEMS
WITHIN DoD

October 1980

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EXECUTIVE SUMMARY

For years, DoD has been criticized for lax management of warranties. The problems cited range from lack of information on the cost of warranties, to lack of information at the user level on warranty terms and procedures for obtaining warranty service, to warranty expiration during extended storage. The most telling criticisms have been of warranties on commercial items with high unit costs, such as vehicles and major household appliances. Such items are the major concern of this study.

A warranty of a commercial item, in simple terms, is a seller's promise that the item, if used properly, will perform without failure for some stated period. If it is not misused but fails within that period, the seller promises that it will be repaired or replaced, at little or no cost to the buyer.

We concluded that, for most commercial items, there was little to gain by refusing a warranty. It is virtually impossible to discover what a company charges for a warranty. Further, if the industry offers a warranty to all buyers and the items are competitively priced, companies rarely offer reduced prices for warranty exclusion. Therefore, when warranties are offered on competitively priced commercial items, we recommend they be accepted.

For most commercial items, the question is not a contracting one, whether to use a warranty, but a maintenance one, how to administer it effectively. When an item fails, maintenance personnel at the user level (e.g., base, post, public work center) diagnose the problem and take whatever action is necessary. If the item is warranted, they must take the warranty terms into account. Therefore, we concluded that local maintenance organizations should be responsible for warranty administration and accordingly, we recommend that they be authorized to develop and apply warranty procedures suited to their local conditions.

At present, local maintenance managers have two choices when a warranted item fails: take the item to a local dealer for repair or use base personnel to repair the item. Both choices have drawbacks. Use of local dealers is DoD policy, but there may not be a dealer close to the base who can perform the work promptly, or the size of the repair may not justify the expense of taking the item to the dealer. On the other hand, if the local maintenance facility repairs the item, it incurs costs which may not have been budgeted and are not reimbursed, and the warranty may be voided as well.

There is a third choice, the in-house service warranty. Private owners of large vehicle fleets, state and local governments, several GSA motor pools and the U.S. Postal Service have entered into these warranty arrangements with vehicle manufacturers. While in-house service warranties are usually associated with vehicle repair, they also could be useful for repairs of household appliances and construction and material handling equipment.

An in-house service warranty is an agreement between the manufacturer and a user that authorizes warranty repairs to be done by the user as well as by a dealer. The local manager decides, case by case, which it will be. If done in-house by the user, the cost will be reimbursed by the manufacturer under the same type of warranty repair arrangement that exists between the manufacturer and the dealer.

In-house service warranties can increase equipment availability and permit better control over the quality of warranty repairs. They also eliminate the risk of voiding a warranty when work is done in-house. Typically, the user organization will initiate action to negotiate an arrangement with the manufacturer's zone or area representative. The manufacturer usually, but not always, will inspect the maintenance facility and the skills of its personnel before agreeing to this arrangement.

The in-house service warranty gives the maintenance organization an added benefit, but does not impose an added burden. With or without this type of warranty, the organization will continue to use dealers for repair work, or, when circumstances dictate,

do the work in-house. The added benefit is that, with the in-house service warranty, the organization may bill the manufacturer for the cost of doing the work in-house. Therefore, we recommend that local DoD maintenance organizations be authorized and urged to enter into these arrangements.

Local maintenance activities will be more likely to use in-house service warranties, however, if a reimbursement problem can be resolved. At present, under law, a manufacturer's reimbursements could not be credited to the local activity but would have to go into the miscellaneous receipts of the U.S. Treasury. We recommend steps be taken to remove this disincentive. One way to do this would be to induce Congress to change the law so that reimbursements would go directly to the organization that did the work. This may not be possible, however. An alternative way would be to permit the activity to establish a separate account in its maintenance budget dedicated to warranty work.

The total of our findings leads to a final conclusion. The nature and significance of warranties on commercial items makes the problem a local one to be solved by action at the local level; it does not need and would not support a major, centralized program, with supporting organization and procedural directives.

1. INTRODUCTION

BACKGROUND

In 1979, both the Defense Audit Service (DAS) and the Surveys and Investigations (S&I) staff of the House Appropriations Committee issued reports criticizing DoD's handling of warranties. They were the latest in a series of critical reports from various sources, including the General Accounting Office.

The DAS concluded that DoD did not have a program to ensure that warranty costs were reasonable or that maximum use of warranty coverage was being made. In its view, warranty provisions were not being exercised because management's visibility of the area was inadequate. In some instances, warranted items were in storage during the entire warranty period, defective warranted items were scrapped or repaired at Government expense, and warranty claims were not processed in a timely manner.

The S&I staff reported that DoD was unable to make full use of vehicle warranties when dealer service was unavailable or slow. Obtaining repair parts overseas was difficult, due to the time consumed in making claims and shipping parts. There also were shortcomings in the administration of warranties on household appliances, subsistence, clothing, and textiles. Users were not informed of the existence of warranties or, for subsistence and clothing, of the role of defective material reports in warranty administration.

The problems mentioned in the DAS and S&I reports fall into five areas:

1. Headquarters visibility over the costs of warranties.
2. User awareness of the existence of warranties on specific items.
3. Availability of information about warranty terms and corrective procedures.
4. Procedures for obtaining warranty service.
5. Length of the warranty period when extended storage or shipping time is involved.

The findings of the S&I staff were given added attention during FY80 budget hearings conducted by the House Appropriations Committee's Subcommittee on Defense in the spring of 1979. The subcommittee's position was that it was time that DoD took action to improve its performance in pursuing its rights under contract warranties.

One such action was to task the Logistics Management Institute to develop policy and procedural changes for handling warranties on commercial items. The study was restricted to commercial items due to the extensive use of warranties on these items and the Federal policy calling for greater reliance on commercial products. The focus was to be on warranties on commercial vehicles, large household appliances, subsistence, clothing, and textiles. Because both unit and total cost of equipments have a strong bearing on the control over product warranties, the procedures and practices examined most closely were those for maintaining administrative use vehicles, light trucks, material handling equipment, stoves, refrigerators, and air conditioners.

APPROACH

The work began with a review of published studies and reports on warranties. We then interviewed officials in OSD acquisition, supply, maintenance, and comptroller organizations; the General Services Administration's (GSA's) Federal Supply Service (FSS) and regional offices; the U.S. Postal Service (USPS); and the Army, the Navy, the Air Force, and the Defense Logistics Agency (DLA). Next, we visited seven military installations to discuss warranty administration with contracts, supply, maintenance, and housing personnel. These were Forts Devens and Eustis; Naval Submarine Base, Groton; Naval Public Works Center, Norfolk; Naval Amphibious Base, Little Creek; Hanscom Field; and Langley Air Force Base. Finally, we discussed warranty practices with representatives of Bell System companies and manufacturers of vehicles and appliances.

Through discussions with DoD personnel, we determined that the S&I staff's report of the difficulties of administering warranties overseas and the shortcomings in handling warranties on subsistence, textiles, and clothing was clear, factual, and still relevant. We have, therefore, incorporated some of their findings in this report.

One of the study products originally contemplated was a DoD guide to provide decision criteria on cost effective purchase and administration of warranties. In the course of the study, we found that the decision to accept a warranty on a commercial product should depend on industry practice and that the decision to buy a warranty on an item of military design should be based on criteria set forth adequately in the Defense Acquisition Regulation (DAR). On the other hand, we found that proper administration of warranties on delivered products was a procedural matter, which should be covered in base operating procedures according to departmental or intermediate-level command direction. As a result, we concluded that a guide, particularly one based on the findings of a study restricted to commercial product warranties, would not be helpful and was not needed. The project monitor agreed.

OVERVIEW OF THE REPORT

Chapter 2 presents the study's findings about warranty usage and administration for (1) vehicles, (2) appliances, and (3) subsistence, textiles, and clothing. The findings may be summarized as follows:

1. FSS is the principal buyer of commercial vehicles used by DoD components. The vehicles are bought by formal advertising and carry virtually the same warranties as comparable vehicles sold to individuals. Although the warranty on vehicles sent overseas covers parts, but not labor, there is no price reduction for this reduced liability. In the 50 states and the territories, DoD users rely on dealers for warranted repairs, but find it necessary, from time to time, to make the repairs themselves.

2. FSS also is the principal buyer of household appliances, and DoD orders the great majority of appliances made available on FSS's supply schedules. The FSS warranty clause covers 12 months, starting six months after delivery or when put in use, whichever comes first. DoD users rely less on dealers for warranted appliance repairs than is the case for vehicles.

3. The Defense Personnel Support Center (DPSC) contracts for subsistence, clothing, and textiles and its policy is to buy warranty coverage. The contracting officer initiates warranty claims, usually based on the results of quality audits conducted at DLA depots.

Chapter 3 presents our conclusions and recommendations. Our principal conclusion is that, if warranty problems are solved, it will be done at the local level through the efforts of users' maintenance organizations. How they organize to administer warranties and assign responsibilities must depend on local conditions.

2. FINDINGS

GENERAL

DAR 1-324 states that the "principal purposes of a warranty in a Government contract are to delineate the rights and obligations of the contractor and the Government for defective items and services and to foster quality performance."

On the other hand, warranties have been described as being obligations assumed by a seller and having two major objectives.¹ One is promotional, to encourage purchases, and the second is protective, to guard the seller from purchasers' unreasonable claims. A second study described warranties in the same terms and, after citing the record of automotive warranties since 1960, studies of warranties on major appliances, and the passage of the Magnuson-Moss Warranty Act of 1975 (P.L. 93-657, 15 USC 2301), concluded that "consumer product warranty experience does not substantiate a warranty's ability to protect the buyer or produce a better product."²

Although these studies cast doubts on the utility of warranties, DAR 1-324.2(b)(4) puts the matter in perspective: "In many instances, as a result of trade practice, the cost of an item to the Government will be the same whether or not a warranty is included. In such instances, it would be in the Government's interest to include such a warranty."

Warranted products can be categorized as consumable or reparable, and each requires a different administrative approach. Consumables typically have low unit prices and are bought in large quantities. Subsistence, textiles, and clothing are examples. Warranty administration is geared to lot sizes or other product groupings, not to individual items. The contracting officer is responsible for action on warranty claims.

¹Udell, Jon G. and Evan E. Anderson, "The Product Warranty As An Element of Competitive Strategy," Journal of Marketing, Vol. 32 (October 1968).

²Gandara, Arturo and Michael D. Rich, Reliability Improvement Warranties For Military Procurement, Rand, R-2264-AF, December 1977, pp 35-38.

Reparables typically have relatively high unit prices. They are operated and maintained by or for DoD personnel. Warranty administration is geared to the individual item. If it fails, it is repaired or replaced. Automobiles, trucks, some types of material handling equipment, some construction equipment, and major home appliances are examples of reparables. Warranty administration is performed at the base level where the equipment is used.

VEHICLE WARRANTIES

Contracting Practices and Warranty Usage

Under the Federal Government's coordinated procurement program, GSA's FSS buys sedans, station wagons, light trucks, and buses for DoD. DoD vehicles are bought separately from those for civil agencies, due in part to DoD's data requirements. The Army Tank Automotive Materiel Readiness Command (TARCOM) also buys commercial vehicles, mainly heavy trucks with tactical uses. DLA, through the Defense Construction Supply Center (DCSC), buys commercial material handling and construction equipment.

FSS generally buys vehicles competitively by formal advertising, with a warranty clause as part of the solicitation terms. Because cost or pricing data are not obtained in formally advertised procurements, warranty costs cannot be identified. FSS has not solicited bids without a warranty.

In general, FSS obtains the same warranty the manufacturer extends to the general public. Its specific features are:

1. 12-month or 12,000-mile coverage for parts and labor on vehicles within the 48 contiguous United States and the District of Columbia.
2. 15-month or 12,000-mile coverage for parts and labor on vehicles in Hawaii, Alaska, Puerto Rico, and the Virgin Islands.
3. 15-month or 12,000-mile coverage for parts only on vehicles outside the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands.
4. No coverage for tires, batteries, and normal maintenance items.
5. Reimbursement by the manufacturer of the cost of warranty work done in-house if the vehicle is "an impractical distance" from a dealer and prior approval is obtained from the manufacturer.

FSS buyers said there is no price reduction on vehicles sent overseas even though labor costs are excluded from the warranty.

TARCOM and DCSC follow the guidance in DAR 1-324, which states that the following factors are to be considered together in deciding whether to buy warranty coverage:

1. Nature of the item, including its planned usage, complexity, and function.
2. Cost of the warranty related to the benefits to be derived from it.
3. Government's ability to enforce the warranty.
4. Trade practice.

In practice, TARCOM uses warranties on commercial items and modified commercial items, but not on items of military design. The warranty is similar to that which the manufacturer gives the general public. TARCOM has asked for alternate bids, with and without warranty, but the automotive manufacturers have refused to bid under those conditions.

DCSC uses warranties for large end items such as construction and material handling equipment. The requirements documents from the Military Departments often ask for warranty coverage. DCSC has made a blanket determination that warranties are appropriate for all procurements of material handling equipment.

In a 1975 report on truck warranties, GAO recommended that DoD and GSA "direct their respective procurement offices to require that agencies use, to the extent practicable, billback agreements to recover the costs of warrantable repairs when it is not practical to take the vehicle to a dealer."³ GAO indicated that DoD agreed with this recommendation and that the Army had instituted changes in its vehicle procurement practices to use billback agreements.

³"Savings Expected from Better Use of Truck Warranties by Government Agencies," PSAD-76-64, 20 March 1975.

Both FSS and TARCOM vehicle warranty contract clauses permit warranty repairs to be performed by the Government and billed to the manufacturer, if approved by the manufacturer in advance. The TARCOM warranty clause for material handling equipment and construction equipment does not require manufacturer approval before the Government performs warranty repairs. We did not find that DoD installations were taking advantage of these billback provisions.

A draft revision to DAR 1-324 was submitted to the DAR Council on 28 February 1980. The recommended revision focused on the requirements to determine a need for and a benefit from a warranty, and to establish appropriate administrative systems to ensure warranties were invoked. In addition, it restated the basic Government policy of acting as a self-insurer, making acceptance of the contract items conclusive, except as regards latent defects, fraud, or such gross mistakes as amount to fraud.

The proposed revision also would make the activity initiating the purchase request responsible for requesting and justifying the use of a warranty. This feature was reinforced by a draft DoD directive which would make supply management activities responsible for monitoring warranty use.

Warranty Administration

DoD users know which vehicles are under warranty and what the terms are. FSS issues a "New Vehicle Guide," which explains the warranty terms and procedures for pursuing warranty claims; warranty data plates also must be "conspicuously installed" in the vehicles. TARCOM also issues materiel fielding plans as well as technical bulletins describing warranty procedures and requires that warranty data plates be attached to the dashboard.

Administration of vehicle warranties is controlled locally, in many cases by the transportation office. Each Military Department has a written policy to use local dealers for vehicle warranty repairs. All activities visited were reasonably close to dealers and generally followed this policy. However, they all indicated that warranted items were repaired in-house when the need was urgent or when it was not worth the cost to take the

vehicle to a dealer.⁴ Each base visited had a complete in-house vehicle maintenance capability, and maintained and repaired vehicles, including construction equipment and material handling equipment, in-house after warranties expired. Although there was general satisfaction with the dealers' performance, there had been some unnecessary delays in getting vehicles repaired and returned, and individual cases of unsatisfactory repairs. Maintenance personnel at most bases said it would be more efficient if they had greater discretion in deciding where the work would be done.

Both GSA and DoD procurement organizations that buy commercial vehicles indicated that they did not get much feedback on warranty experience, nor did they have much involvement in warranty administration after award of the contract.

The S&I staff of the House Appropriations Committee reported that vehicle warranties were not used fully overseas. The staff suggested two alternatives. One was to waive warranty coverage on vehicles destined for overseas, with a reduction in contract price. The other was to obtain improved billback arrangements with simplified claim procedures. Because of the way vehicles are purchased, and the consistent refusal of manufacturers to offer price reductions, the first suggestion does not seem promising.⁵

In-House Service Warranties

Many large fleet owners, such as car rental and trucking firms, utilities, and state and local governments, have the option of deciding who shall do warranty repairs on a case-by-case basis, without prior approval from the manufacturer. They have entered

⁴ Air Force Technical Order TO 36-1-42, "Policies Governing Warranty Procedures For Air Force Vehicles," cautions the vehicle maintenance officer "to prevent excessive out-of-commission times on low cost warranty repairs."

⁵ Nevertheless, OSD wrote to the Commissioner of the Federal Supply Service on 11 April 1980, addressing the use of warranties on supplies and services obtained from FSS schedules. OSD suggested that FSS schedules provide prices with and without warranties, leaving to the customer the option of buying the warranty coverage. It suggested this technique be considered initially for household furnishings (particularly appliances) and office machines. FSS, as of 1 September, had not responded to this suggestion.

into agreements known as in-house service warranties with vehicle manufacturers, which permit them to choose either their own shop or a dealer's to perform a particular warranty repair. If the work is done in-house, the manufacturer reimburses the fleet owner for labor and parts.

There are obvious benefits from the use of in-house service warranties. They can give local managers increased flexibility in deciding how to accomplish warranty repairs, so that the work can be done as effectively and efficiently as possible. This can enhance equipment availability and help keep local maintenance shops working at optimum levels. In addition, it can give local managers better control over the quality of warranty repairs.

About half of the Bell System companies have negotiated in-house service warranties for their vehicles. The arrangements are agreed to after the manufacturer is satisfied that the maintenance facilities have the necessary space and equipment and the mechanics can do the work. In addition, the agreement may stipulate that the company will keep failed parts for some number of days in case the manufacturer wants to inspect them.

Under this arrangement, the Bell system company may either use a dealer for warranty work or do the work itself and bill the manufacturer for parts and labor. Parts usually are billed at actual cost. Labor billings are calculated by multiplying the time from the manufacturer's flat rate manual by a predetermined hourly rate. Manufacturers generally require their dealers and the companies to submit the same type of information to get reimbursement of warranty work. AT&T personnel believe that the in-house service warranty is a successful, money-saving program, especially considering that pursuing a warranty repair through a dealer ties up both the vehicle and company employees for a significant time.

The U.S. Postal Service (USPS) has negotiated in-house service warranties for all its American Motors General (AMG) vehicles and for 1600 new Dodge 1-ton trucks.

The arrangements include a labor rate to be used for warranty reimbursement for all 300 USPS vehicle maintenance facilities (VMFs) across the country. Warranty reimbursement claims are usually submitted by the local facility.

Estimated resources needed for warranty repairs are considered in the annual budgets for USPS VMFs. Actual reimbursements from manufacturers for warranty repairs go into a USPS general fund, not back to the VMF. However, the cost of doing warranty work is excluded from calculations to determine vehicle cost per mile, the principal measure of a VMF's performance.

When fleetwide problems are to be fixed in-house, USPS headquarters negotiates a lump sum reimbursement for the whole fleet and tells the local facilities not to submit warranty claims. This eliminates much of the paperwork. USPS indicated that the in-house service warranty was very successful.

Four of the 10 GSA regions have in-house service warranties for American Motors vehicles. GSA vehicle maintenance shops operate under a system which allows money received from a manufacturer as reimbursement for warranty repair to be credited to the account that funded the warranty repair. However, under current agreements, American Motors does not reimburse warranty work by check. Instead, it credits the GSA with an equal amount towards the purchase of parts. Motor vehicle managers at these GSA regions are satisfied with the warranties and believe they benefit the Government.

DoD users said that in-house service warranties would increase their flexibility and would be workable. Those whose activities were not industrially funded saw one major drawback to the arrangement. Section 484 of Title 31 USC requires that reimbursements such as those forthcoming with in-house service warranties be sent directly to the U.S. Treasury, even though the local activity has expended its own resources to do the work.

APPLIANCE WARRANTIES

Contracting Practices and Warranty Usage

DoD orders appliances from Federal supply schedules which are, in essence, indefinite quantity, indefinite delivery contracts awarded by FSS. Appliances are on single award schedules, although awards typically are broken down by geographic zones. While there will be only one award for each model in one zone, the schedule may include models of two or more manufacturers. As requirements are identified, DoD components place orders against the appropriate schedules for delivery directly to the users. DoD activities are the principal users of the Federal supply schedules for appliances.

The warranty terms in the appliance schedules are essentially the same as those offered the general public, covering parts and labor for one year. Unlike that for the commercial warranty, the FSS warranty period generally starts six months after receipt of the unit, or the date the unit is placed in service, whichever is earlier. The exact terms of the warranty are listed in the Federal supply schedule, and a copy of the warranty is to be packed with each unit.

Appliance warranties do not cover labor costs for units outside the 48 contiguous states and the District of Columbia. As with the FSS vehicle warranty, there is no apparent price reduction for this reduced manufacturer's liability, nor is there any provision for the extended time often needed to secure replacement parts.

Warranty Administration

Warranty administration for appliances is more haphazard than for vehicles. This may be due in part to the lower cost of the appliances. FSS indicated that it receives little feedback on warranty experience, and is not involved in warranty administration. Conversely, bases reporting repeated problems with specific makes and models of appliances said they received little satisfaction from higher headquarters or FSS in terms of corrective action on later buys.

We found that some bases did not know exactly which appliances were under warranty, let alone the terms of the specific warranties. FSS does not publish an appliance handbook similar to its "New Vehicle Guide." To find the exact warranty terms, the user must look in the FSS appliance schedule, but the personnel involved in appliance warranty administration rarely have copies available. Although FSS contracts require warranty certificates to be shipped with each appliance, these certificates often are not shipped, or, if they are, they describe the manufacturer's normal commercial warranty, not the FSS one.

Appliance warranty administration usually involves more than one base organization, but no one organization has been assigned complete responsibility. Only the Air Force has a regulation pertaining to appliance warranty administration, although one of the Navy activities visited had a local written procedure.

Five of the seven bases visited maintain and repair appliances in-house. The other two use contract maintenance for most appliances, although both have an in-house maintenance capability and use it for some items.

The volume of warranty actions on appliances at the bases visited was low. Reasons for this include:

1. Low dollar value of many appliance repairs, making it more cost-effective to do them in-house.
2. Lack of procedures for verifying warranty status prior to repair.
3. Long storage time prior to installation, resulting in little or no time left in the warranty period.
4. Few appliance breakdowns during the warranty period.
5. Immediate need for the failed item.

Without a system to monitor and control warranties, the ability to pursue warranty rights becomes a matter of chance. It depends on the base repairman's ability to recognize that the appliance may be under warranty.

A spokesman for a large appliance manufacturer told us that in-house service warranties were not used widely. However, he said that an in-house service warranty probably could be arranged for a DoD organization if its maintenance capabilities were acceptable. The use of contract maintenance probably could be accommodated within such an in-house service warranty arrangement as well. The spokesman indicated that local zone representatives could arrange the details with bases, once the concept was approved at group headquarters.

WARRANTIES ON SUBSISTENCE, TEXTILES, AND CLOTHING

Contracting Practices and Warranty Usage

DLA's Defense Personnel Support Center (DPSC) is the central DoD procurement agency for subsistence, textiles, and clothing. Most purchases include warranty provisions and are awarded after competition. Textiles bought by DPSC usually are made available to clothing contractors as Government-furnished material for use in manufacturing uniforms and other clothing.

Warranty Administration

The relatively low unit cost of products in these categories, coupled with the large quantities customarily purchased, requires a different approach to warranty administration. Quality audits, which measure items against specifications, are relied upon to trigger warranty action. Under the quality audit program, DPSC sets an acceptable defect level for each item. Defects above the set levels result in warranty action by the DPSC contracting officer.

When audit findings indicate an unacceptable defect level, the contracting officer may exercise one of five options listed in DPSC's standard warranty of supplies clause:

1. Require an equitable adjustment in contract price.
2. Screen the supplies at the contractor's expense and return all nonconforming supplies for correction or replacement.

3. Require the contractor to screen the supplies at designated depots and correct or replace all nonconforming supplies.
4. Return the supplies to the contractor for screening and correction or replacement.
5. Return or hold the supplies for the contractor's account and recover the contract price.

The quality audit approach is augmented by individual defective material reports filed by users and logged and tracked by DPSC buying branches. An unsatisfactory trend in those reports can cause the contracting officer to request quality audits and take warranty action. However, relatively few claims result from deficiency reports; most warranty actions result from quality audits performed at the supply depot.

The findings of the 1979 S&I staff report referred to above are still valid. The staff found that the warranty system works reasonably well once defects are reported, but the number of deficiency reports on file at DPSC is low in comparison to the annual volume of purchases. Deficiency reports are not being filed in all cases, and few managers know that they are a key part of warranty administration. Managers continue to complain that the existence of supply warranties is not communicated to the field and, as a result, they do not know the products are warranted.

The staff's principal conclusion bears repeating. Information on subsistence, clothing, and textile warranties should be put in the hands of the users. The role that defective material reports play in invoking warranties should be explained, and the procedures to be followed should be spelled out.

3. CONCLUSIONS AND RECOMMENDATIONS

CONTRACTING PRACTICES AND WARRANTY USAGE

Warranty administration is not likely to be improved by changing acquisition regulations and contract clauses. We have noted that contracting initiatives to improve warranty use, such as billback provisions, have not been picked up at the user level. Contract language only provides the basis for action. It does not make it happen.

The decision to buy or not to buy a warranty is made by the contracting officer, using criteria in the DAR. For most commercial items, this decision is moot if the industry offers a warranty to all buyers and the item is competitively priced. Little is gained by refusing the warranty because most manufacturers have declined to make alternate proposals and rarely offer a price reduction for warranty exclusion. Therefore, for most commercial items, the main concern is not whether to use a warranty, but rather, how to administer the warranty effectively. For most of the items studied, the question is even more clearly an administrative one for DoD; the contracts are formed and awarded by FSS after formal advertising.

Nevertheless, the DAR Council should take action regarding the contractual aspects of warranty use. The contracting officer should be required to determine that the Government would benefit from use of a warranty and that the warranty can be administered in the environments in which the items will be used. The February 1980 draft revision of DAR 1-324 had these requirements, and the version ultimately approved by the DAR Council should retain them. In this regard, however, we found nothing in the study that would justify as complete and detailed a change to DAR as that embodied in the draft revision.

The DAR Council also should ensure that DAR warranty clauses do not prevent user activities from entering into in-house service warranties for reparable items. Similarly, the DAR Council should assure that standard clauses used by DoD components do not

exclude labor costs from warranties on items used outside the 50 states and the territories. The Council also should take action to have FSS remove this exclusion from its warranty clauses, particularly those for vehicles and appliances. Labor costs should be a part of the clause so that overseas bases can take full advantage of in-house service warranties.

WARRANTY ADMINISTRATION

Procedures

Successful warranty administration starts with someone knowing that a failed item is warranted and what the warranty terms are. Maintenance personnel at the user level make repair decisions on failed items. If an item is warranted, the warranty terms will affect those decisions. Therefore, warranty administration should be the responsibility of the local maintenance organization.

Failure to pursue warranty claims results from ignorance of the warranty and its terms, an immediate need for the item, or a decision that it is more cost-effective to repair the item in-house. Ignorance can be attacked by training and effective local warranty administration procedures.

OASD(MRA&L) should issue a directive or instruction describing the key elements of warranty administrative procedures and require the departments to take actions to assure that procedures are developed and applied at the local level. Such procedures should require:

1. Conspicuous marking of warranted items when received.
2. An inventory of warranted items, listing the warranty period and the dealers that may be called in event of failure.
3. Verification of warranty status before work on failed items is authorized.
4. A record of the nature, cost, and performing organization of all warranty work.

Local procedure also should delineate the roles of supporting organizations, such as supply and contracting. The local supply organization has a supporting role in

warranty administration. Supply personnel receive, inspect, store, identify, and mark warranted items. Therefore, they must know the warranty terms for newly received items.

Further, in many cases, local contracting personnel award purchase orders for appliances from the FSS schedules. They should indicate, on the face of the purchase order, the extent to which the warranty clause in the schedule differs from the manufacturer's normal commercial warranty. The purchase order also should highlight other schedule requirements, such as packing warranty certificates with each item and informing consignees where to report discrepancies. This will alert receiving and inspection personnel (most likely from Supply) to these special requirements and facilitate proper marking of warranted items.

In-House Service Warranties

Immediate need for a failed item is a controlling factor in repair decisions. If no practical alternative exists, the item will be fixed in-house and returned to use, warranty or no warranty. Responsibility for warranty decisions must be clearly designated, and administrative procedures must permit alternative approaches to warranty repairs. The importance of proper warranty administration and alternative approaches to warranty repair for commercial items will increase as the trend toward greater reliance on commercial products continues in DoD.

The best alternative is the in-house service warranty. Once agreed to in negotiations between the manufacturer's zone representative and local management, this arrangement allows the local maintenance manager to choose either the local dealer or base maintenance to perform a particular warranty repair, without voiding the warranty or incurring unscheduled costs. Because this can represent a significant risk to the manufacturer, the manufacturer's representative usually will ask to inspect a maintenance facility's shops and personnel before agreeing to an in-house service warranty.

in-house service warranties are beneficial because they can increase equipment availability and permit better control over the quality of warranty repairs. They also are a way of gaining greater benefit from warranties on items sent to overseas bases. Properly designed, they should not impose an extra burden on local maintenance organizations; they merely provide an option that is not now available.

Therefore, in cooperation with the Military Departments, OASD(MRA&L) should take the necessary steps to facilitate the use of in-house service warranties. It should issue guidelines assigning ultimate responsibility and authority for negotiating such agreements to the user organizations and setting forth the basic features to be included, such as, the basis for reimbursing labor and material costs and the procedure for submitting reimbursement claims. It also should develop and make available to the Military Departments and their major commands, a program describing in-house service warranties and the steps to be followed in negotiating local agreements with manufacturers. The steps should include, for example, reference to inspection of local DoD maintenance shops and examination of technicians' skills as well as reimbursement claim procedures.

OSD, particularly OUSD(RE) and OASD(C), should take steps to solve the problem of reimbursements, so that local maintenance activities have greater incentive to negotiate in-house service warranties. Two possibilities suggest themselves. An obvious solution would be for Congress to change applicable laws and regulations to permit direct reimbursement to the organization that performed the work. Another possibility would be to establish, in each maintenance budget, a separate account dedicated to warranty work, and fund these accounts during the budget process. This way, the local organization would not be penalized for better use of resources and the Government as a whole would still benefit from the reimbursement.

Most in-house service warranties cover vehicle repair. They also could be used for warranted household appliances, construction equipment, and material handling

equipment. Discussions with manufacturers indicate that they would be receptive to the idea of in-house service warranties at DoD installations. OUSD(RE) should contact the appropriate manufacturers to explore such arrangements. If agreement in principle can be reached with a manufacturer, the Military Departments then should authorize local installations to work out the details with that manufacturer's local representative.

Consumables

The quality audit program is the principal tool for administering warranties on consumable items. The problems that exist relate not to quality audits but to the ancillary defective item reporting system. While it is not realistic to expect that all deficiencies in consumables will be reported, the record could be improved by putting better information in the hands of supply and user organizations. Therefore, DLA should devise and institute a procedure to require the center procuring the consumable to issue bulletins to all users identifying the warranted items, explaining the warranty terms, the quality audit program, and how defective material reports are used to enforce warranties.

OTHER OBSERVATIONS

The use of warranties on products built to military specifications or used for military purposes is outside the scope of this study. What we have learned, however, suggests that warranties on these products are of questionable value and does not substantiate the often-stated opinion that warranties foster quality performance. Further, their use is not compatible with the basic Government policy of being a self-insurer. It would be appropriate to change the DAR to forbid purchase of a warranty unless the contracting officer can make an affirmative finding that there will be clear benefit to DoD and demonstrate that the warranty can be administered in the different environments in which the product will be used. When making these determinations, contracting officers should get information from user-level maintenance organizations. The Appendix contains a recommended DAR policy statement on warranty use. The balance of the present DAR 1-324 should be changed to conform to this policy statement.

Assuming the recommended changes in warranty administration are adopted, the contracting officer would be encouraged to buy warranties on commercial items. Nevertheless, where warranty terms are likely to be uneconomic or unenforceable, as might be the case on some items used overseas, the contracting officer should be advised to pursue price reductions for warranty exclusion.

APPENDIX

PROPOSED DAR POLICY STATEMENT ON WARRANTY USE

1-324 Warranties.

1-324.1 General.

(a) A warranty is a promise or affirmation given by a seller to a purchaser regarding the nature, usefulness, or condition of the supplies or performance of services to be furnished. The principal purpose of a warranty is to delineate the rights and obligations of the contractor and the Government for defective items and services.

(b) It is basic Government policy to act as a self-insurer, making acceptance of the contract items conclusive except as regards latent defects, fraud, or such gross mistake as to amount to fraud. However, warranties survive acceptance of the contract items for a stated period of time or use, or until the occurrence of a specified event, notwithstanding other contractual provisions pertaining to acceptance by the Government. Thus, they allow the Government additional time after acceptance in which to assert a right consistent with the guidelines of this paragraph.

(c) It is industry practice to warrant many types of commercial products. Where this is so, and the prices have been set by competition, the contracting officer will accept warranties on these products. However, if warranty use appears to be uneconomic or unenforceable, the contracting officer will pursue exclusion of the warranty, with appropriate downward adjustment of price.

(d) For all other products, the contracting officer will request a warranty only after determining that the warranty terms can be enforced and that the extra cost is reasonable in relation to the expected benefits. Such a determination will be based on information from program, supply, maintenance, and quality assurance personnel and, particularly in regards to enforcement, from the users' maintenance organizations. Any such determination must be approved by the Chief of the Purchasing Office.

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This report examines warranties on commercial items bought for use by DoD components. Although the study also included subsistence, textiles, and clothing, primary attention was given to administrative use vehicles, light trucks, household appliances, and material handling and construction equipment. The report concludes that emphasis must be placed on administration of warranty provisions by the activities using the equipment rather than by the contracting office and the terms of the contract; that responsibilities must be assigned		

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to and procedures must be developed by the maintenance organizations at the user level; that in-house service warranties, a form of billback used extensively by private fleet owners, by state and local Governments, and by USPS and GSA, should be adopted by DoD organizations to get greater benefit from warranties on commercial items.

Under the in-house service warranty, the using organization at its option, may take the equipment to a dealer for repair or do the work itself and bill the manufacturer for the cost of labor and parts used in doing the work. The report also concluded that maximum benefit would not be realized unless some way could be found to offset the disincentive of the current law which requires such reimbursements to go to the U.S. Treasury and not to the organization that did the work. ←

Principal recommendations were that local installations be required to develop warranty administration procedures and encouraged to enter into in-house service warranties with manufacturers of vehicles and other high dollar commercial equipment. Other recommendations dealt with actions that followed directly from the other conclusions.

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